



Pemberton, HR. (2006). Back to the future: history and the pensions crisis. *Re:search*, 11(March 2006), 8 - 10.  
<http://hdl.handle.net/1983/1054>

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# Back to the future: history and the pensions crisis

Last summer, Dr *Hugh Pemberton*, from the Department of Historical Studies, co-organised a conference at the British Academy. It brought together leading experts to debate the makings of Britain's pensions crisis and the way forward, along with policy-makers, representatives from the financial services sector, think-tanks, pressure groups and trade unions. Here he reports on some of their findings.

**T**he problem of security in old age is amongst the most urgent political issues in Britain today. It seems to be generally accepted that we face a major crisis over the next few decades which is largely the product of our ageing population, but

But if we are to craft and implement such a settlement, we would be well advised to understand better how the present crisis has arisen. And to do that, we need better to understand the history of British pensions over at least the past half-century.

became increasingly complex and increasingly inefficient. This has implications for those seeking to defuse the pensions crisis. Firstly, much of the complexity is 'locked-in' by contracts that are expensive to break. This constrains options for

## | We face a major crisis over the next few decades

also of the complexity and inefficiency of the current arrangements. The Pensions Commission (set up by the Government to examine the problem) recently concluded that 'major reform of the UK pension system is needed to create a new settlement for the twenty-first century'.

### **The importance of history**

In crafting its proposals for change, it is notable that the Pensions Commission found itself highly constrained by history. So it's perhaps surprising that the Commission's recent report devoted only two of its 460 pages to any consideration of how the present systems developed. In fact, a notable feature of the current pensions debate is a persistent failure to consider the roots of the pensions crisis as well as possible solutions to it. An important reason why history matters is that pensions embody very long-term contracts (sometimes implicit but often explicit). This has not fitted well with the short-term nature of British politics.

Within the constraints of past decisions, changes proved relatively easy for governments to make, since the costs would not come home to roost for a long time. The result was a major 'reform' of the system at least once a decade after the end of the Second World War. But each change left a very long-term legacy. Consequently, over time the system

change. Secondly, an important lesson from the past is surely that we need to avoid short-term fixes and build a solution flexible enough to avoid the need for further reform for some time to come.

Let us consider three examples of how historical legacies are shaping the present crisis, and shaping solutions.

### **History and the state basic pension**

We tend to think of our national insurance contributions building up a fund out of which our basic state pension will be paid – as Beveridge proposed in his famous 1942 report *Social Insurance and Allied Services*, the foundation stone of Britain's postwar welfare state. In reality, this is not the case. When the National Insurance Pension was implemented in 1946, the then Labour government judged it politically impossible to pay anything but a full pension to new retirees who had suffered the privations of the 'hungry thirties' and the Second World War. It therefore decided to drop Beveridge's proposal that there be a 20-year transition to →



→ full pension rights and effectively shifted to paying pensions out of taxation. But this move was concealed from contributors, who continued to believe that their contributions would build up a fund out of which a future pension would be paid.

This had far-reaching consequences. For one thing, since it would be funded out of current taxation, governments now had an incentive to keep the state pension as low as possible. At the same time, in the minds of British workers the idea was created that a firm financial contract existed between them and the state in respect of 'their' pension – an illusion which persists today. This explains why a basic pension that is insufficient to keep people out of poverty endured, and so explains an important element of the present crisis. Furthermore, despite the inadequacy of that pension, the implicit contract embodied within it has limited the Pensions Commission's room for manoeuvre. The public expenditure implications of shifting everyone to a better deal led the Commission to back away from advocating a single unified state pension, bringing together the existing state basic pension and the earnings-related top-up.



## The political costs of transferring a substantial amount of money from men to women are very high

### Women and pensions

One might also cite the role of history in creating a pensions system that profoundly disadvantages women. This is also the product of the past – of a world in which the 'family breadwinner' was assumed to be male and the earnings of women were 'pin money'. Of course, that world has (largely) gone, but those old assumptions shaped the present position. And because the *financial costs* of addressing such discrimination, and the *political costs* of transferring a substantial amount of money from men to women are very high, history again imposes limits on the options available to today's policy-makers.

### Back to the future

Finally, and remarkably, neither the Commission, nor any of the

enormous volume of comment that has followed its second report, seems to have recognised the historical resonances of its proposals for a new National Pensions Saving Scheme with funds invested in the stock market. There is much to be said for the proposal, but the historical auguries are not good. The idea is reminiscent of Labour's 'National Superannuation' proposals in the late 1950s – a scheme rejected by the electorate in 1959 after a successful campaign by the financial sector to label it as 'nationalisation by the back door'. There are signs of a similar response developing amongst pensions companies today but, if the scheme is to be implemented, the Pensions Commission needs to recognise the lessons of the past and devise a system that removes direct control of the funds from government.

So, history matters. And our lack of understanding of that history matters. If we are to craft an effective and enduring solution to the pensions crisis, we have to understand how history has shaped that crisis; we have to learn the lessons of history (not least the very long-term consequences of decisions taken for short-term political advantage); and we have to recognise the ways in which history has closed off some of our policy options.

The proceedings of the conference, *Britain's Pensions Crisis: History and Policy*, will be published by the British Academy in September 2006. ■

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